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EEB FOR A/S DANIEL S. SULLIVAN
EEB/CBA FOR FRANK MERMOUD, TIM GILMAN

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SUBJECT: MINISTER SHARIFOV DISCUSSES EPC, BUDGET AND ECONOMY

Classified By: Political-Economic Counselor Robert Garverick,
Reasons 1.4.(b) (d)

11. (C) Summary: Azerbaijan Minister of Finance Sharifov heads to Washington next week for EPC meetings and WTO discussions with views on the international financial crisis -- and lower oil prices -- formed in part by Russian Minister of Finance Kudrin, who recently hosted a CIS financial summit. Sharifov this week is focused on budget discussions at parliament, which is reviewing the GOAJ's proposed 2009 revenue and expenditure forecasts. Azerbaijan's State Oil Fund, while no longer receiving the windfall inflows of summer, will still directly transfer USD 7 billion to the federal government next year. Azerbaijan does not have large exposure to foreign currency-denominated debt, but worries that revenues (from oil sales) and state reserves are dollar denominated. The Minister was downbeat on economic prospects for Turkey, Ukraine, Central Europe and Kazakhstan. End Summary

12. (C) Embassy Officers met November 8 with Azerbaijan Minister of Finance Samir Sharifov to discuss preparations for the November 17 meeting in Washington of the Economic Partnership Commission (EPC), and subsequent meetings on WTO accession at the Office of the U.S Trade Representative. Azerbaijan's Finance Minister outlined current thoughts on the country's macroeconomic situation and FY2009 budget process, with constant reference to the ongoing international financial crisis. The Minister noted repeatedly a strong interest, within the scope of EPC or otherwise, in receiving an overview of U.S. Treasury plans to address the global credit crunch, and to receive a read-out of President Bush's November 15 G-20 Summit.

2009 Federal Budget under Discussion

13. (C) Minister Sharifov expected to spend the entire week before EPC in front of Parliament discussing the government's proposals for the 2009 federal budget. The GOAJ is estimating 2009 government revenues at 12.177 billion AZN (USD 15 billion), or 28 percent of projected GDP. This forecast represents an increase of 16 percent over 2008 revenues. The draft government budget calculates 2009 expenditures at 12.355 billion AZN (USD 15.253 billion), leaving a deficit of approximately USD 250 million. Government expenditures, Sharifov said, would thus increase 11.7 percent over 2008 levels. According to press reports, the State Oil Fund (SOFAZ) will transfer 5.676 billion AZN (USD 7 billion) to the federal budget in 2009.

Lower Oil Price, Financial Crisis Have Impact

¶4. (C) The Minister stated emphatically that lower oil prices do not threaten budget revenues, as the government will continue to set a benchmark of USD 70 per barrel, and assumes that the value of the U.S. dollar vis-a-vis a market basket of currencies will be stable. (Note: during the banner days of summer, the GOAJ considered raising this estimate to USD 80 per barrel, as oil reached USD 140-145 per barrel in global markets. That proposal was rolled back this fall, without being implemented. End Note) Declining revenue from oil sales, Sharifov said, rather has an impact on transfers to the State Oil Fund, which received windfall inflows earlier this year. (Note: SOFAZ transfer a proportion of its revenues directly to the federal government; excess amounts are managed within the framework of Azerbaijan's Extractive Industries Transparency Initiative undertakings. End Note)

¶5. (C) Minister Sharifov reported that Azerbaijan's total government reserves, including funds held by SOFAZ, now exceed USD 18 billion. Total foreign debt held by the GOAJ or Azerbaijani entities, meanwhile, totals USD 7.5 billion. Thus, he said, Azerbaijan's macroeconomic situation is strong and its currency is stable. Moreover, Azerbaijan's budget is mostly funded internally, and is not dependent on foreign loans, "as in Hungary or Turkey."

¶6. (C) Azerbaijan's banks have limited exposure to international financial markets. Many banks are capitalized internally, although several have reached out to foreign markets for funding to broaden their resource base and leverage financing. In total, Azerbaijan's banks owe USD 2 billion in foreign currency-denominated debt. This is less, the Minister said, than the total proposed increase in spending in the 2009 federal budget.

Minister in Moscow for Financial Summit

¶7. (C) Sharifov noted that he had recently traveled to Moscow for a CIS financial summit. There, Russian Finance Minister Kudrin had presented Russia's views on the international financial crisis -- views that mainly hold the U.S. to blame. Sharifov said that the USG has a responsibility to lead efforts to restore confidence in markets, bolster its banking/financial sector and protect the value of the U.S. dollar (in which oil contracts are concluded). (Note: Sharifov said that in a side conversation, Russian Finance Minister Kudrin had told him that the biggest economic mistake that Russia had made was its decision to agree to sell oil and gas in dollar-denominated contracts. End Note)

¶8. (C) Sharifov, meanwhile, was extremely negative about Ukraine and Kazakhstan, alleging that the latter, despite large oil revenues, was suffering from heavy exposure to foreign currency-denominated debt and a lack of transparency in its state oil fund. Ukraine, Sharifov said, had made an error in deciding to refund the savings that citizens lost during the bank failures at the time of the demise of the USSR. Azerbaijan would not agree to do this, as the Government of Ukraine's decision had led to a confidence crisis and "bank run."

¶9. (C) Comment: In Washington, Sharifov will be a good interlocutor at the EPC. He is knowledgeable and well spoken and, coming directly from parliamentary hearings on the 2009 federal budget, will be up to date on macroeconomic activity. At the same time, he is likely to convey points from the CIS financial summit, and call for the USG to take concrete steps to preserve the value of the dollar and steady global equity and bonds markets. A high-level outbrief on the November 15 G-20 Summit would likely do much to assuage Azerbaijan's fears of financial instability and let Baku feel that it has a seat at the table for important talks in Washington, as well as Moscow.